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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. [redacted] 58

JUNIOR TOY CORPORATION, PEERLESS TOOL & ENGINEERING COMPANY, PENN ELECTRIC SWITCH COMPANY, UNITED STATES MOTORS CORPORATION, BADGER METER MANUFACTURING COMPANY, JOSTEN ENGINEERING COMPANY, AMERICAN GAS MACHINE COMPANY, BRAD FOOTE GEAR WORKS, INC.,

Petitioners,

vs.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

HAROLD E. MARKS,
HENRY W. DIERINGER,
MICHAEL F. MULCAHY,
Counsel for Petitioners.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. 734

JUNIOR TOY CORPORATION, PEERLESS TOOL & ENGINEERING COMPANY, PENN ELECTRIC SWITCH COMPANY, UNITED STATES MOTORS CORPORATION, BADGER METER MANUFACTURING COMPANY, JOSTEN ENGINEERING COMPANY, AMERICAN GAS MACHINE COMPANY, BRAD FOOTE GEAR WORKS, INC.,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Petitioners, Junior Toy Corporation, Peerless Tool & Engineering Company, Penn Electric Switch Company, United States Motors Corporation, Badger Meter Manufacturing Company, Josten Engineering Company, American Gas Machine Company and Brad Foote Gear Works, Inc., all corporations, respectfully pray that a Writ of Certiorari issue to review the judgment of the Court of

Claims entered in the above entitled cause on December 1, 1953; the time for filing this Petition having been extended to April 30, 1954 by order of this Court, dated February 27, 1954.

I

Summary Statement of Matter Involved

All of the Petitioners filed separate suits in the Court of Claims to recover certain income taxes paid by the Petitioners upon income from war contracts, all of which were subject to renegotiation, which income was claimed to have been erroneously accrued by the Petitioners and reported in their tax returns prior to the date of renegotiation of said contracts. It is contended the amount of the profits allowable to Petitioners under said contracts and for which amounts the Government then became liable, was definitely determined and fixed for the first time when the renegotiation was completed. The Petitioners having kept their books and made their tax returns on the basis of an accrual accounting, should not have paid income tax on the undetermined amount of income until such time as the exact amount was finally fixed and determined. The same question being raised in all of the cases herein, the Court of Claims consolidated them and rendered a single decision. The schedule of dates and amounts for the various Petitioners is set forth in the opinion of the Court of Claims.

II

Relevant Part of Statute Involved

Section 3806 (a) (4) of the Internal Revenue Code provides as follows:

> "Exception. The foregoing provisions of this subsection shall not apply in respect of any contract if the taxpayer shows to the satisfaction of the Commis-

sioner that a different method of acccounting for the amount of the payment, repayment, or disallowance clearly reflects income, and in such case the payment, repayment, or disallowance shall be accounting for with respect to the taxable year provided for under such method, which for the purposes of subsection (b) and (c) (credit for prior tax) shall be considered a prior taxable year."

III

Question Presented

The sole question herein involved is whether the amount of the allowable profit to which the Petitioners ultimately became entitled under war contracts subject to renegotiation, and which amount was for the first time determined upon renegotiation as set forth in the Stipulation of Facts in the Record herein, constituted taxable income in the year in which it was received, or constituted taxable income in the year when the renegotiation finally determined the amount of income. Petitioners contend that being on an accrual basis, the amount of income being undetermined and in suspense, the profits, if any, are taxable income in the year that the final determination was made.

IV

The Reasons Relied on for the Allowance of the Writ

The reasons for petitioning this Court to review the decision and judgment of the Court of Claims in this case are as follows:

1

The holding of the Court of Claims herein that the income in question was taxable in the year in which it was actually received rather than in the year when the profit was finally fixed and determined upon renegotiation is based entirely on the Court of Claims' decision in the *Holmes*

Projector Company vs. *The United States* case, 123 Court of Claims 278. That decision violates the principles of income taxation where accounts and returns are based on the *accrual basis as distinguished from the cash basis* and is contrary to the following decisions of this Honorable Court.

In *Lichter et al.* v. *United States,* 68 S. Ct. 1294, decided by this Court on June 14, 1948, this Court was called upon to pass on the constitutionality of the Renegotiation Act of 1942, as amended. Of necessity this Court's decision in that case, involved an interpretation of the vital and controlling provisions of the Act.

In an exhaustive opinion, reviewing the necessity for the Act, and the underlying purpose and intent of Congress in respect thereof, and sustaining its constitutionality, this Court, after pointing out that the Government could have drafted the industry of America, in war time, as it drafted soldiers for the Armed Forces, among other things said:

> "The plan for Renegotiation of profits, which was chosen in its place by Congress appears in its true light as the very symbol of a free people united in reaching unequalled productive capacity and yet retaining the maximum of individual freedom consistent with a general mobilization of effort." * * *
>
> "The plan proved itself readily adaptable to the needs of the times. It called for initial contract estimates based upon the best available information at the time of entering into the contracts. Production proceeded at once on the basis of those estimates. The final net compensation, however, resulted from a renegotiation made after both parties had had the benefit of actual experience under the contract. This determination of the allowable profit was guided by many relevant factors."

It is thus unmistakably clear that this Court has now defined the original War Contracts, prior to renegotiation as "estimates", and has further conclusively stated that "The

allowable profit",—and, of course, nothing else, in respect of such contracts, was income subject to taxation—was the amount which "resulted from a renegotiation made after both parties had had the benefit of actual experience under the contract."

The inevitable conclusion from the foregoing decision is that a War Contractor had no right to any amount as "allowable profit" until the renegotiations had been concluded. It follows, beyond peradventure of doubt, that the "allowable profit" became taxable income only in the year during which the renegotiations occurred.

As stipulated herein, the renegotiation of the Contracts here in question were concluded in subsequent years. "The allowable profit" of the Petitioners from said contracts was then first determined, and, therefore, the Petitioners should not have accrued, as they did, and paid taxes on any amount of receipts from said contracts for the year in which received, but should have paid taxes in the year the renegotiation was completed.

In *Spring City Foundry Co.* v. *Commissioner*, 292 U. S. 182, the Supreme Court said:

> "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed the right accrues. * * * Items must be accrued as income when the events occur to fix the amount due and determine liability to pay."

The decision of this Court in *Security Flour Mills* v. *Commissioner of Internal Revenue*, 321 U. S. 281, it is submitted, completely supports the contention advanced by the Petitioners herein. In that case the Court said:

> "Where the accrual method of accounting is used, items of income and expenses must be allocated to the

years in which the right to receive, or the obligation to pay has become final and definite in amount."

2

The question presented is an important question of Federal Income Tax Law, which should be settled by the Supreme Court. The rights of the Petitioners to be legally and properly taxed, and not otherwise, is directly involved.

3

In the *Holmes Projector Company* v. *The United States* case, 123 Court of Claims, 278, decided by the Court of Claims and relied upon as authority in deciding the present cases, the Court of Claims made an obvious error, which was taken as the basis of its conclusion. That error is stated on Page 6 of the decision as follows:

> "It is obvious that Congress intended when it enacted Section 3806, supra, that the full amount of earnings payable or paid under the terms of Government Contracts should be *regarded as income in the year in which such amounts were earned by performance* and were payable or paid in accordance with the accrual or cash basis of accounting." (Italics supplied.)

There is no statement in section 3806 re amounts "earned by performance", and it is a fundamental principle of Internal Revenue jurisprudence as expressed by the Supreme Court in *Gould* v. *Gould*, 245 U. S. 151, that in the interpretation of tax statutes "it is the established rule not to extend their provisions by implication beyond the clear import of the language used, or to enlarge their operations as to embrace matters not specifically pointed out."

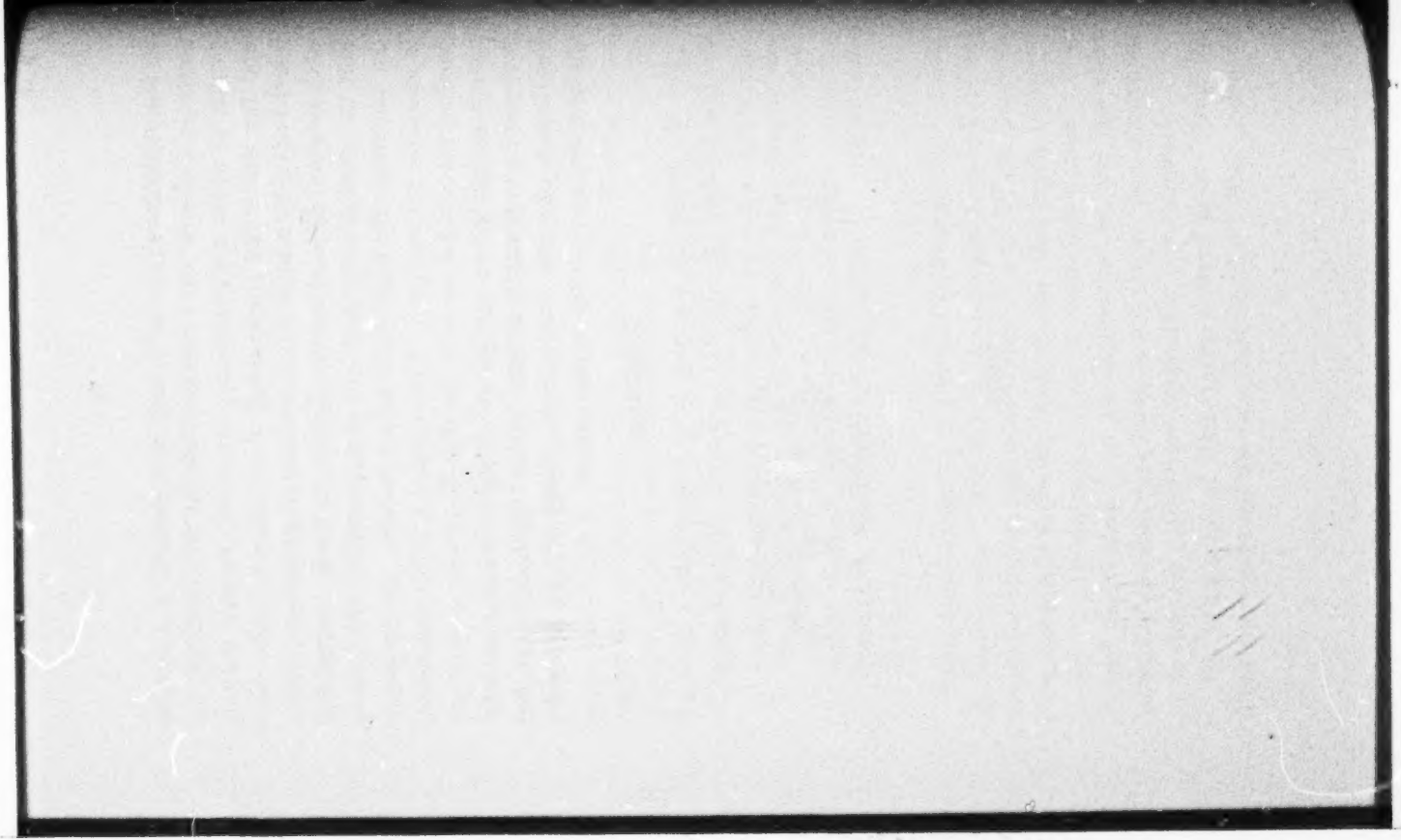
The Stipulation of Facts in the Record herein shows the Petitioners accrued the face amount of the War Contracts

in the years in which the money was received and erroneously paid income taxes thereon, but that the amount of the profits to which the Petitioners ultimately became entitled and for which the Government then became liable, were agreed upon by renegotiation in subsequent years. It thus obviously and unquestionably is shown by the Record herein, that the accrual method of accounting used by Petitioners did not correctly state their actual income for the years in which the tax was paid. The amounts held in suspension, pending the renegotiation of the War Contracts, should not have been treated as profits, nor taxes paid thereon, until such profits were finally determined and fixed, therefore, the Petitioners overpaid their income taxes in the years in question and are entitled to refunds.

Conclusion

For the foregoing reasons, it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

HAROLD E. MARKS,
HENRY W. DIERINGER,
MICHAEL F. MULCAHY,
Counsel for Petitioners.



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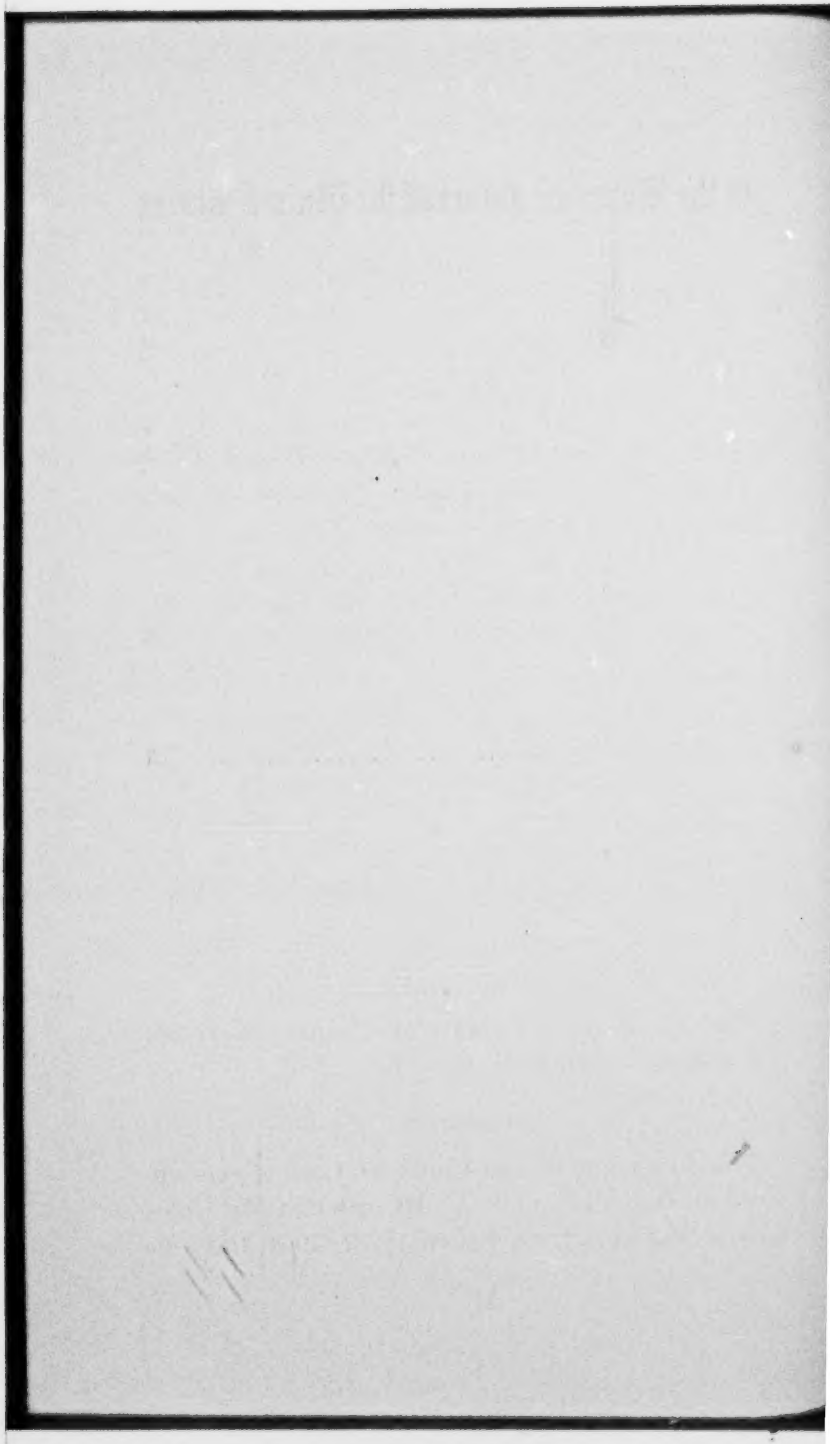
CITATIONS

Case:

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 58

JUNIOR TOY CORPORATION, PEERLESS TOOL & ENGINEERING COMPANY, PENN ELECTRIC SWITCH COMPANY, ET AL., PETITIONERS

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 57-58) is reported at 116 F. Supp. 730.

JURISDICTION

The judgment of the Court of Claims was entered on December 1, 1953. By order of Mr. Chief Justice Warren dated February 27, 1954, the time

for filing a petition for a writ of certiorari was extended to and including April 30, 1954. (R. 59.) The petition for a writ of certiorari was filed on April 29, 1954. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Whether the taxpayer-corporations, which kept their books and reported their income on the accrual basis, and which completed war contracts and were paid the face amounts of such contracts in earlier years, could properly defer accruing and reporting such payments until later years because renegotiation proceedings were concluded in such subsequent years.

STATUTE INVOLVED

The applicable portions of the pertinent statute are set forth in the Appendix, *infra,* pp. 5-8.

STATEMENT

The taxpayers, all corporations, filed petitions in the Court of Claims seeking refunds of income and excess profits taxes which had been paid by them. (R. 1-2, 4-9, 10-16A, 18-22A, 24-29, 30-35, 37-42, 44-52.)

The petitions alleged in substance that the taxpayers kept their books and reported their income on the accrual basis; that the taxes which had been paid by them were based upon accrual of income resulting from the performance of war contracts with the Government; that renegotia-

tion proceedings, to which the contracts by their terms were made subject, were completed in subsequent years; that the income resulting from performance of the war contracts should not have been accrued until the renegotiation proceedings were concluded; that the taxpayers filed claims for refund of the taxes in question; and that the claims were disallowed by the Commissioner of Internal Revenue. (R. 1-2, 4-5, 11-12, 19, 24-25, 31, 37-38, 44-45.)

On motions of the Government (R. 2-4, 9-10, 17-18, 23-24, 29-30, 35-36, 42-43, 52-54) and after argument, the petitions were dismissed on the authority of *Holmes Projector Co.* v. *United States,* 105 F. Supp. 690 (C. Cls.), certiorari denied, 344 U.S. 912, rehearing denied, 345 U.S. 914.

ARGUMENT

Apparently accepting (Pet. 3-4, 6-7) the conclusion of the Court of Claims (R. 58) that the sole issue presented here is identical with that involved in *Holmes Projector Co.* v. *United States,* 105 F. Supp. 690 (C. Cls), certiorari denied, 344 U.S. 912, rehearing denied, 345 U.S. 914, the taxpayers, relying upon the same cases, merely reiterate the arguments advanced in the petition for a writ of certiorari and the petition for rehearing in that case (Pet. 4-7). Those arguments are without merit for the same reasons stated in the brief in opposition in the *Holmes Projector Co.* case.

CONCLUSION

The decision below is correct, and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Special Assistants to the Attorney General.

JUNE, 1954.

APPENDIX

Internal Revenue Code:

SEC. 3806 [as added by Section 508, Revenue Act of 1942, c. 619, 56 Stat. 798]. MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT.

(a) *Reduction for Prior Taxable Year.*—

(1) *Excessive profits eliminated for prior taxable year.*—In the case of a contract with the United States or any agency thereof, or any subcontract thereunder, which is made by the taxpayer, if a renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as "prior taxable year") is eliminated and, in a taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount of excessive profits eliminated or the amount of excessive profits eliminated is applied as an offset against other amounts due the taxpayer, the part of the contract or subcontract price which was received or was accrued for the prior taxable year shall be reduced by the amount of excessive profits eliminated. * * *

* * * * *

(3) *Deduction disallowed.*—The amount of the payment, repayment, or offset described in paragraph (1) or paragraph (2) shall not constitute a deduction for the year in which paid or incurred.

(4) *Exception.*—The foregoing provisions of this subsection shall not apply in respect of any contract if the taxpayer shows to the satisfaction of the Commissioner that a different method of accounting for the amount of the payment, repayment, or disallowance clearly reflects income, and in such case the payment, repayment, or disallowance shall be accounted for with respect to the taxable year provided for under such method, which for the purposes of subsections (b) and (c) shall be considered a prior taxable year.

(b) [as amended by Section 701(c), Revenue Act of 1943, c. 63, 58 Stat. 21, and Section 14(b), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231]. *Credit Against Repayment on Account of Renegotiation or Allowance.*—

(1) *General rule.*—There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 1, Chapter 2A, Chapter 2B, Chapter 2D, and Chapter 2E, is decreased by reason of the application of paragraph (1) of subsection (a) * * *.

* * * * *

(3) * *Credit for barred year.*—If at the time of the payment, repayment, or offset described in paragraph (1) or paragraph (2) of subsection (a), refund or credit of tax under Chapter 1, Chapter 2A, Chapter 2B, Chapter 2D, or Chapter 2E, for the prior taxable year, is prevented (except for the provisions of section 3801) by any provision of the internal-revenue laws other than section 3761, or by rule of law, the amount by which the tax for such year under such chapters is decreased by the application of paragraph (1) or paragraph (2) of subsection (a) shall be computed under this paragraph. There shall first be ascertained the tax previously determined for the prior taxable year. The amount of the tax previously determined shall be the excess of—

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return (de-

* Prior to enactment of Section 701(c) of the Revenue Act of 1943, *supra*, this paragraph was numbered (2). Prior to enactment of Section 14(b) of the Individual Income Tax Act of 1944, *supra*, the third sentence of this paragraph was as follows:

> The amount of the tax previously determined shall be (A) the tax shown by the taxpayer upon his return for such taxable year, increased by the amounts previously assessed (or collected without assessment) as deficiencies, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or (B) if no amount was shown as the tax by such taxpayer upon his return, or if no return was made by such taxpayer, then the amounts previously assessed (or collected without assessment) as deficiencies, but such amounts previously assessed, or collected without assessment, shall be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax. * * *

termined as provided in section 271(b)(1) and (3)), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in section 271(b)(2), made.

There shall then be ascertained the decrease in tax previously determined which results solely from the application of paragraph (1) or paragraph (2) of subsection (a) to the prior taxable year. The amount so ascertained, together with any amounts collected as additions to the tax or interest, as a result of paragraph (1) or paragraph (2) of subsection (a) not having been applied to the prior taxable year shall be the amount by which such tax is decreased.

* * * * *

(c) *Credit in Lieu of Other Credit or Refund.*—If a credit is allowed under subsection (b) with respect to a prior taxable year no other credit or refund under the internal-revenue laws founded on the application of subsection (a) shall be made on account of the amount allowed with respect to such taxable year. * * *

(26 U.S.C. 1946 ed., Sec. 3806.)

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